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SENSITIVE
SIPDIS

MCC FOR AMBASSADOR DANILOVICH
DEPT FOR E - U/S JEFFREY
USAID FOR ADMINISTAROT FORE
TREASURY FOR A/S LOWERY AND IA BAYLY
DEPT PASS USTR SCHWAB
OMB FOR JACQUELINE STRASSER
MCC ALSO BENT, MORFORD, LONGI
STATE ALSO EAP MARCIEL AND EB NELSON
USAID ALSO FOR DEPUTY ADMINISTRATOR KUNDER, ANE WARD/SOLAT, ODP
TUNER/DELP
USTR ALSO FOR AUSTR WEISEL, EHLERS, BRYAN, HEUGEL

E.O. 12598: N/A

TAGS: [EINV](#) [ECON](#) [KMCA](#) [EAID](#) [PRESL](#) [ID](#)

SUBJECT: INDONESIA SHOULD BE AWARDED MCC COMPACT STATUS

11. (SBU) Summary. The Millennium Challenge Corporation Board should declare Indonesia Compact eligible at its December meeting. Over the past decade, Indonesia has transformed itself from an authoritarian state to the world's third-largest democracy committed to policies that promote political and economic freedom, investments in education and health, control of corruption, and respect for civil liberties and the rule of law. Indonesia now meets the criteria for Compact eligibility. We should recognize this progress. We should also recognize Indonesia as an increasingly important bilateral partner with growing influence in the international community. Naming Indonesia as Compact eligible will give Indonesian reformers additional confidence to continue their efforts to build a modern, free-market and democratic nation. As funding decisions are made, it is essential to factor in Indonesia's size, complexity and strategic importance. End summary.

12. (SBU) Ten years ago, Indonesia was a mess. Its authoritarian ruler had been overthrown after three decades in power. In 1998 the economy shrank by nearly 14 percent in the wake of the Asian financial crisis. Social violence erupted in parts of the country. Compare that picture of the world's fourth-largest country and largest Muslim-majority nation with today's Indonesia. Indonesia is now firmly democratic; while the upcoming 2009 parliamentary and presidential elections are newsworthy, the fact that they are happening is not news. In fact, last year Freedom House named Indonesia the freest country in Southeast Asia. And this year, Indonesia passed the "Control of Corruption" indicator for the first time after several years of consistent, continuous improvement. This is no accident. President Yudhoyono came to power in 2004 with a pledge to fight corruption. Indonesia has made remarkable progress in battling corruption; on its first MCC scorecard five years ago it ranked at the 11th percentile. It is now at the 56th percentile. Our MCC threshold program provided key support to this effort.

13. (SBU) Similar advances have been made on the economic front. While it has not been able to escape the impacts of the current financial crisis, Indonesia is operating from a sound macroeconomic base that it has purposefully put into place over the past several years. Economic growth is slowing, but is still projected to exceed five percent this year and next. And the current government has demonstrated an ability to act sensibly in the face of crisis. Earlier this year it took the politically unpopular decision to reduce fuel subsidies in order to minimize its budget deficit. Challenges clearly remain. Despite increased expenditures (the

government has committed to devote 20 percent of the budget to education), much work needs to be done to build effective health and education systems in this vast island nation. And with more than 100 million people living on under \$2 per day, Indonesia has almost twice as many poor as the combined total populations of the other three countries being considered for Compact eligibility. This demography, in conjunction with the Indonesian government's anti-poverty programs, offers the United States a huge opportunity to demonstrate the impact of an MCC compact on poverty alleviation.

¶4. (SBU) Declaring Indonesia to be Compact eligible would acknowledge the progress of the past decade and give the government additional confidence to carry out further reforms. While President Yudhoyono and team have made steady progress in transforming this country, nationalist and protectionist sentiment remains strong. This nationalism will be given voice in the 2009 Parliamentary and Presidential elections campaign. MCC Compact status would give the reformers added credibility as the elections approach.

¶5. (SBU) MCC Compact eligibility would also allow us to work more closely with Indonesia as a partner on issues of joint interest. By recognizing and rewarding Indonesia for its progress and providing assistance to help it continue on its reform path, we will also deepen and broaden the structure of our relationship. We are already finding more and more areas where we can work together with Indonesia. We are cooperating on a host of environmental issues that could reduce deforestation and combat climate change. We have invited Indonesia to participate in the upcoming financial summit. And economically, Indonesia will continue to grow in importance; it is the only G-20 country eligible for MCC Compact status and Goldman Sachs estimates that in four decades Indonesia's economy will be

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bigger than Japan's. We should be working together with Indonesia now as it becomes more and more important regionally and globally.

¶6. (SBU) We understand that the MCC budget will be tight and competition intense. But Indonesia - through its own hard work - has met the criteria for MCC Compact eligibility. An MCC Compact here could potentially have a greater impact on poverty reduction than in any other country in the world. It would generate further reforms. And it would help build our relationship with an important Muslim-majority country that has demonstrated that Muslim-majority countries can also be democratic and secular.